

Message Text

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SUBJECT: COMMENTS ON FY 1977/78 FMG BUDGET

REF: A) LAGOS 3679, B) LAGOS 3686, C) LAGOS 3752, D) LAGOS 3860

1. SUMMARY: WITH ONLY TWO FISCAL YEARS LEFT BEFORE THE MILITARY GOVERNMENT'S ANTICIPATED RETURN TO THE BARRACKS, BUDGET AND ACCOMPANYING ACTIVIST BUDGET SPEECHES WERE EXPECTED TO IMPOSE MORE INTENSE COMMITMENTS TO COMPLETE FMG PRIORITY PROGRAMS BY 1979. THUS 25 PERCENT INCREASE IN ESTIMATED FEDERAL RECURRENT AND CAPITAL EXPENDITURES WAS NOT A SURPRISE DESPITE ITS INFLATIONARY IMPACT. ALSO AS EXPECTED, REGIME TOOK CREDIT FOR PARTIALLY CORRECTION PROBLEMS CONFRONTING THE ECONOMY WHEN IT ASSUMED CONTROL OF JULY 1975. MAJOR ACHIEVEMENTS CLAIMED BY HEAD OF STATE OBASANJO INCLUDE DECLINE OF INFLATION FROM 35 PERCENT (FY 1975/76) TO 20 PERCENT (FY 1976/77); GDP INCREASE BY 10 PERCENT FOR FY 1976/77; AGRICULTURAL PRODUCTION INCREASE BY 3 PERCENT (ESTIMATED POPULATION GROWTH RATE IS 2.6 PERCENT); ELIMINATION OF SUPPLY BOTTLENECKS. FOR FY 1977/78 OBASANJO AND FEDERAL MINISTER OF FINANCE OLULEYE PROMISED TO CONTINUE TO FIGHT INFLATION AND ATTAIN A MORE EQUITABLE DISTRIBUTION OF WEALTH. NEW FISCAL YEAR ALSO HERALDED AS YEAR OF AGRICULTURE, INDUSTRY, AND RESIDENTIAL CONSTRUCTION. AGRICULTURE BUOYED BY TRIPLING OF MINISTRY BUDGET,

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PROBABILITY OF INCREASED LOANS TO THE AGRICULTURAL SECTOR, REDUCTION OF TAXES AND DUTIES ON AGRICULTURE/AGRI-BUSINESS PROJECTS, AND ENCOURAGEMENT OF LARGE SCALE AGRICULTURE/AGRI-BUSINESS PROJECTS, AND ENCOURAGEMENT OF LARGE SCALE AGRICULTURAL PROJECTS ON THE STATE LEVEL. THESE ARE LONG TERM MEASURES, HOWEVER, AND FOR THE NEXT FEW YEARS NIGERIA WILL LIKELY BE DEPENDENT ON INCREASING FOOD IMPORTS. INDUSTRIAL GROWTH LARGELY DEPENDENT ON FOREIGN PARTICIPATION.

NONETHELESS, ALTHOUGH IMPORT SUBSTITUTION AND CONSEQUENT TARIFF AND NON-TARIFF BARRIERS AGAINST MANUFACTURED IMPORTS LOOM AS WAVE OF FUTURE, FOREIGN INVESTMENT CAPITAL REMAINS WARY OF NIGERIA'S INDIGENIZATION INTENTIONS. BUDGET SPEECHES REVEALED NO NEW MAJOR RESTRICTIONS AGAINST FOREIGN BUSINESS BUT DISALLOWANCE OF EQUITY SCRIPT ISSUES AND REDUCTION OF CONSULTANCY/TECHNICAL AND MANAGEMENT FEES REPRESENT FURTHER DISCOURAGEMENT TO EXPATRIATE BUSINESS. THIS IN TURN OFFSET BY NEW PETROLEUM INVESTMENT INCENTIVES EMERGING SAME WEEK AS BUDGET THOUGH NOT MENTIONED IN PUBLIC BUDGET PRESENTATIONS. HOUSING CONSTRUCTION CREDITS SHOULD BE LESS RESTRICTIVE, BUT CONSUMPTION RESTRAINED BY HOLDING LID ON MOST WAGE INCREASES. INFLATION DESPITE VERBAL ASSURANCES REMAINS CHIEF THREAT. IF GOVERNMENT'S HUGE CAPITAL EXPENDITURE BUDGET OF DOLLARS 8.8. BILLION IS REALIZED, INFLATION PROBABLY WILL JUMP BACK INTO 40 PERCENT RANGE, HOLLOWNESS OF FMG PROMISE TO PROVIDE MORE EQUITABLY WEALTH REFLECTED IN LACK OF ANY SUBSTANTIVE NEW WEALTH LEVELING PROGRAMS. END SUMMARY

2. THE ECONOMY. NOT SURPRISINGLY, OBASANJO CLAIMED SIGNIFICANT PROGRESS IN AREAS OF CONTROLLING INFLATION, INCREASING GDP, REVERSING THE DECLINE OF AGRICULTURE, AND EASING SUPPLY BOTTLENECKS. ALTHOUGH SOME PROGRESS MADE, WE BELIEVE CLAIMS ARE OVERSTATED. INFLATION HAS EASED FOR MOMENT BUT GOVERNMENT STATISTICS CLAIMING THAT IT DROPPED FROM OVER 40 PERCENT IN DECEMBER 1975. TO ABOUT 20 PERCENT BY DECEMBER 1976 ARE HARD TO ACCEPT, PARTICULARLY WITH MONEY SUPPLY (M1) INCREASING BY 60 PERCENT DURING SAME PERIOD. GDP DID INCREASE BY 10 PERCENT FOR FY 1976/77 BUT MOST OF INCREASE WAS REGISTERED BY DOMINANT PETROLEUM SECTOR WHICH WAS RECOVERING FROM ITS 1975 SLUMP. ALTHOUGH LONG TERMS PROGRAMS TO INCREASE LIMITED OFFICIAL USE

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AGRICULTURAL PRODUCTION HAVE BEEN STARTED, THEY HAVE NOT YET HAD ANY EFFECT. THE SHORT TERM OPERATION FEED THE NATION HAS AT BEST BEEN MIXED SUCCESS. BE SUPPLY IMPASSES, CONGESTION PERSISTS ESPECIALLY IN LAGOS WHERE 185 ODD SHIPS (96 OFFICIALLY) ARE WAITING TO UNLOAD.

3. FOR THE SHORT TERM THE ECONOMY WILL RETAIN ITS BOOM TOWN FLAVOR WITH INFLATION WORSENING BECAUSE OF INCREASED DEVELOPMENT PLAN SPENDING. OVER THE NEXT TWO TO THREE YEARS SOME BASIC PHYSICAL INFRASTRUCTURE PROBLEMS SHOULD BE RESOLVED. LONGER TERM ECONOMIC PICTURE IS MURKY BUT REMAINS DEPENDENT ON NIGERIAN PETROLEUM POLICY WHICH WILL MAXIMIZE PRODUCTION, THE WILLINGNESS OF OVERSEAS BANKS TO LEND DEVELOPMENT CAPITAL IN THE FACE OF NIGERIA'S DECLINING FOREIGN EXCHANGE RESERVES, AND A MORE ATTRACTIVE INVESTMENT POLICY TO LURE NEEDED FOREIGN MANAGEMENT EXPERIENCE AND TECHNOLOGY.

4. REVISED DEVELOPMENT PLAN AND BALANCE OF PAYMENTS. OBASANJO ADMITTED OBLIQUELY THAT THE THIRD NATIONAL DEVELOPMENT PLAN HAD

ACCOMPLISHED LITTLE IN MANY AREAS OTHER THAN COMPLETION OF FEASIBILITY STUDIES. HE MAINTAINED THAT PLAN WAS NOW POISED TO TAKE OFF. FY 77/78 CAPITAL BUDGET OF DOLLARS 8.8 BGWLION REFLECTS THIS STANCE. ALTHOUGH THE HEAD OF STATE CONDITIONED BUDGET ON INFUSION OF DOLLARS 4.3 BILLION FROM NEW INTERNAL AND EXTERNAL BORROWING (THUS GIVING THE FMG A FOREIGN SCAPEGOAT IN CASE FMG TIMING IS DERAILED), IT PROBABLE THAT FMG WILL DISBURSE GREAT DEAL THIS FISCAL YEAR FOR DEVELOPMENT. WITH CIVILIAN RULE DUE IN 1979, TIME IS GROWING SHORT FOR MILITARY LEADERSHIP TO IRREVOCABLY SET IN MOTION ITS DEVELOPMENT PROGRAM. FMG'S HASTE HAS RESULTED IN A BUDGET 25 PERCENT HIGHER THAN IN FY 76/77 AND ALSO HELPS TO EXPLAIN THE OUSTER OF FORMER MIN FINANCE EKUKINAM SHORTLY BEFORE THE BUDGET SPEECH WAS GIVEN. EKUKINAM IS RUMORED TO HAVE SUPPORTED AN AUSTERITY BUDGET FOCUSED MORE ON COMBATTING INFLATION AND THEN ON FULFILLING QUICKLY THE GOAS OF THE DEVELOPMENT PLAN.

5. ALTHOUGH GOVERNMENT ACKNOWLEDGED THAT IT DOES NOT EXPECT TO LIMITED OFFICIAL USE

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ADD TO ITS FOREIGN EXCHANGE RESERVES IN CY 1977, IT IS CLEAR THAT IT WILL INCUR A BALANCE OF PAYMENTS DEFICIT, PROBABLY GREATER THAN THE CY 1976 DOLLARS 440 MILLION DEFICIT. DESPITE THE IMPORT BAN, THE NIGERIAN TRADE SURPLUS SHOULD CONTINUE TO SHRINK WITH PETROLEUM DOMINATED EXPORT EARNINGS REMAINING STABLE BUT IMPORTS CONTINUING TO MOUNT BECAUSE OF DEMANDS OF DEVELOPMENT PLAN. EXPANDED CAPACITY OF NIGERIAN PORTS WILL FACILITATE IMPORT INFLOW. FM G HOWEVER ANTICIPATES A DECLINE IN ITS INVISIBLES DEFICIT (FROM EST. DOLLARS 2.9 BILLION IN CY 1976 TO EST. DOLLARS 2.5 BILLION IN CY 1977) LARGELY BECAUSE OF CUTBACKS IN EXPATRIATE MANAGEMENT AND CONSULTANCY FEES AND THE 1976 INSURANCE DECREE WHICH PROVIDES THAT ALL IMPORTS MUST BE INSURED BY NIGERIAN REGISTERED INSURANCE COMPANIES. INSURANCE SAVINGS COULD AMOUNT TO DOLLARS 300 MILLION IN COMING YEAR. EXECUTION OF DEVELOPMENT PLAN PROJECTS NEVERTHELESS WILL REQUIRE IAN INCREASE IN INVISIBLE PAYMENTS WHICH MAY SHOW FMG INVISIBLES DEFICIT ESTIMATE FOR CY 1977 TO BE OVERLY OPTIMISTIC.

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6. IMPORT RESTRICTIONS. DIFFICULT AT THIS TIME TO QUANTIFY IMPACT OF IMPORT RESTRICTIONS. HOWEVER, SINCE 1976 BAN ONLY RESULTED IN ESTIMATED DOLLARS 60-70 MILLION TRADE LOSS, LIKELY 1977 BAN SHOULD PRODUCE ABOUT A DOLLARS 100 MILLION OFFICIAL REDUCTION. NONETHELESS, MAIN IMPACT OF BAN WILL BE COSMETIC. EXPECT SMUGGLING TO INCREASE ESPECIALLY IN MUCH DESIRED ITEMS LIKE LACE AND CHAMPAGNE. BANNING OF AUTOMOBILES OVER 2500 CC PARTIALLY BLUNTS NEW INITIATIVES OF US CAR MANUFACTURERS TO PENETRATE MARKET WITH FULL RANGE OF MODELS.

7. FOREIGN INVESTMENT IN NIGERIAN ECONOMY. BUDGET SPEECHES SAID LITTLE ON SUBJECT. HOWEVER, FMG DISALLOWAL OF BONUS AND SCRIPT SHARES ISSUED AFTER SEPTEMBER 30, 1976 WIDELY VIEWED AS ACTION BY FMG AGAINST PERCEIVED FOREIGN PROFITEERING. FMG DECISION TO REDUCE FUTURE CONSULTANCY AND TECHNICAL FEES CEILING FROM 60 TO 50 PERCENT AND MANAGEMENT FEES FROM 5 TO 3 PERCENT IS FURTHER SEEN BY SOME AS DELIBERATE FMG SALAMI TACTICS TO WHITTLE DOWN EXPATRIATE PROFITS WITHOUT RESORTING TO A MORE TRAUMATIC WIDE RANGING ACTION. WHILE THESE STEPS GIVE CONCERN TO NUMBER OF OBSERVERS WHO SEE CONTINUED ATMOSPHERE OF DISTRUST, FMG OFFICIALS FROM HEAD OF STATE DOWN TO EXECUTIVES IN ECONOMIC MINISTRIES EMPHASIZE IN PRIVATE CONVERSATIONS THAT AMERICAN INVESTMENT IS VERY MUCH WANTED. FMG PROPOSALS FOR NEW INCENTIVES FOR OIL EXPLORATION AND PRODUCTION (LAGOS 4025) ALSO COULD INDICATE MORE POSITIVE FMG POSTURE.

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8. BANKING. AFTER TWO YEARS OF ALMOST CONTINUAL CRISIS, THE BANKING SECTOR WELCOMED THE NO MAJOR BAD NEWS CONTENT OF THE BUDGET SPEECHES. ON POSITIVE SIDE WERE: INCREASED INTEREST RATES ON GOVERNMENT SECURITIES (PLUS 1/2 PERCENT); ADMISSION THAT FMG NEEDS DOLLARS 4.3 BILLION TO FINANCE FY 77/78 CAPITAL BUDGET; PROBABLE DEEPENING OF INTERNAL FINANCE SYSTEM VIA NEW STOCK ISSUES AND STATE GOVERNMENT BOND ISSUES; PUBLIC ANNOUNCEMENT THAT FMG WILL SEEK FUNDS IN FOREIGN CAPITAL MARKETS; ALLOWING OF MERCHANT BANKS TO PROVIDE DEMAND DEPOSIT SERVICES. ON NEGATIVE SIDE: BANKS NOT HAPPY THAT NEW LOAN GUIDELINES FORCING THEM TO DIVERT 6 PERCENT LOANABLE FUNDS TO CONSTRUCTION AND 5 PERCENT TO AGRICULTURE.

BANKS HAVE NO PROBLEM MEETING CONSTRUCTION REQUIREMENT BUT COMPLAIN THAT HISTORICALLY FEW AGRICULTURE LOAN APPLICATIONS HAVE PROVED TO BE GOOD RISKS. PENALTY FOR NOT MEETING REQUIREMENT IS TO DEPOSIT BALANCE IN NON-INTEREST BEARING ACCOUNT AT CENTRAL BANK.

9. ONLY RHETORIC FOR THE COMMON MAN. BOTH OBASANJO AND FINANCE MINISTER OLULEYE CONTENDED IN THEIR TALKS THAT CORNERSTONES OF FMG ECONOMIC POLICY WERE TO FIGHT INFLATION AND TO ATTAIN A MORE EQUITABLE DISTRIBUTION OF WEALTH. HOWEVER, ALTHOUGH OBASANJO CHARACTERIZED THE BUDGET AS ONE OF AUSTERITY AND SACRIFICE, IT WILL ACTUALLY BE INFLATIONARY IF FINANCING IS FOUND TO COMPLETELY FUND THE CAPITAL EXPENDITURE BUDGET. THE FMG WILL ALLOW AN UP TO 7 PERCENT INCREASE IN WAGES FOR THOSE NOW EARNING UNDER NAIRA 30000 ANNUALLY. HOWEVER, THIS WILL ENSURE ONLY A PARTIAL RECOVERY FROM THE PAST EFFECTS OF INFLATION (LAGOS 3668). ALSO, SINCE NO PROGRAMS DESIGNED TO REDISTRIBUTE WEALTH ANNOUNCED, INDIGENIZATION PROGRAM WHICH WILL BENEFIT LARGELY THE UPPER AND UPPER MIDDLE CLASS (LAGOS 646), REMAINS THE FMG'S MAIN COMMITMENT TO WEALTH LEVELING. ON OTHER HAND, THE GOVERNMENT SEEMS TO BE MAKING SERIOUS EFFORT TO RESOLVE SHORTAGE AND HIGH COST OF HOUSING BY MAKING CREDIT MORE AVAILABLE. ALSO IN EFFORT TO BRING MORE NIGERIANS OUT OF RURAL SUBSISTENCE ECONOMY AND INTO PRODUCTIVE SECTOR OBASANJO PLEDGED TO MAKE AVAILABLE 5 PERCENT OF ALL FEDERALLY RETAINED REVENUES AND 10 PERCENT OF STATE REVENUES TO LIMITED OFFICIAL USE

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LOCAL OVERNMENTS. IN ADDITION, COOPERATIVE BANKS WILL BE ESTABLISHED IN EACH STATE. THE FEDERAL SAVINGS BANK WILL ALSO EXPAND ITS SERVICES INTO THE COUNTRYSIDE. ALTHOUGH COMMENDABLE, IT IS UNLIKELY THAT NIGERIA HAS ENOUGH TRAINED PERSONNEL TO SUCCEED IN SIGNIFICANTLY UPGRADING RURAL INFRASTRUCTURE. PERHAPS REALIZING THIS WEAKNEWS, FMG HAS TRIED TO RECRUIT SOME FOREIGN BANKS (AT LEAST ONE FROM 7. .) TO MANAGE THE COOPERATIVE BANKS IN RETURN FOR 25 PERCENT EQUITY SHARE. SO FAR THERE HAVE BEEN NO TAKERS.

10. BEST PROSPECTS FOR U.S. BUSINESS. LACKLUSTER CONTENT OF THE BUDGET SPEECHES OFFERS LITTLE IN WAY OF NEW INITIATIVES FOR U.S. TRADE AND INVESTMENT. OBVIOUS EXCEPTION IS INCREASE IN SIZE OF NATIONAL DEVELOPMENT PLAN FROM DOLLARS 48 TO 65 BILLION (ANALYZED SEPTTEL AND SEPAIR) AND SPURRED ACTIVITY IN AGRICULTURE AND RESIDENTIAL CONSTRUCTION SECTORS. WITH NEW EMPHASIS ON AND VISIBLE IMPLEMENTATION OF LARGE SCALE FARMS, THERE ARE EXCELLENT PROSPECTS FOR INCREASED FARM EQUIPMENT SALES. RELATED AGRI-BUSINESS JOINT VENTURES WILL ALSO BECOME MORE IMPORTANT, ALSO GOOD OPPORTUNITIES FOR DEVELOPERS OF MAJOR FARM TRACTS. IN CONSTRUCTION SECTOR, JOINT VENTURES IN RESIDENTIAL BUILDING AND IN MANUFACTURE OF BUILDINGPRODUCTS SHOW GOOD PROMISE; IMPORTS OF LATTER ITEMS (PLUMBING, FLOOR AND WALL COVERINGS, ETC.) SHOULD JUMP.

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